SBA MANAGEMENT REVIEW: OFFICE OF CREDIT RISK MANAGEMENT

HEARING

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SBA MANAGEMENT REVIEW: OFFICE OF CREDIT RISK MANAGEMENT

WEDNESDAY, FEBRUARY 5, 2020

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 11:35 a.m., in Room 2360, Rayburn House Office Building. Hon. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Finkenauer, Golden, Kim, Evans, Schneider, Delgado, Craig, Chabot, Burchett, and Hern.

Chairwoman VELÁZQUEZ. Good morning.

The Committee will come to order. I thank everyone for joining us this morning, and I want to especially thank the witness for being here with us today.

This morning, the Committee will examine the management and performance of SBA's Office of Credit Risk Management, otherwise known as OCRM. It is responsible for conducting oversight of SBA's lending programs and its $120 billion 7(a) and 504 loan portfolios.

All of us are acutely aware that access to capital plays a vital role in the success of our nation's 30 million small businesses. Without it, small businesses cannot stock their shelves, pay their employees, or upgrade equipment. Capital is the key to unlocking opportunities to grow and create new jobs in the local economy. Yet, this Committee has heard from numerous small businesses from across the country, and they consistently tell us that one of the biggest challenges they face is accessing affordable capital.

The SBA 7(a) loan program plays an essential role in filling the gap left by the private markets. In fiscal year 2019, almost 52,000 small businesses were approved for 7(a) loans, injecting over $23 billion in long-term capital into local communities across the country and supporting approximately 500,000 jobs. To optimize SBA's lending programs, SBA established the Office of Credit Risk Management within the Office of Capital Access. OCRM conducts reviews of lenders to ensure that they are complying with the program requirements.

While the office played an important role in lender oversight, unprecedented growth in the program combined with deficiencies identified by GAO in SBA's credit risk management prompted congressional action. To that end, Congress passed the 7(a) Lending Oversight Reform Act, which codified OCRM and gave it the tools needed to conduct proper oversight and hold non-compliant lenders accountable.

Today, I would like to learn more about how the SBA is implementing the legislation. The regulation was expected to be finalized months ago, so I am eager to hear when the final rule will be published.

Secondly, I would like to find out what is currently working at OCRM, and what more can be done to address the ongoing concern the Inspector General has with high-dollar, early-default loans, which present a significant credit risk to the 7(a) program.

Finally, I would like to know more about the steps you are taking to address the concerns of the Inspector General's November report. The report highlighted some areas where there is room for improvement, and my motto always is, if it is not perfect, let's make it better.

So, on the heels of that IG report, and in anticipation of SBA's budget submission to Congress, this hearing is a timely one.

We look forward to hearing from the Director of the Office of Credit Risk Management, Ms. Susan Streich, regarding the challenges she has faced since taking over at OCRM, as well as whether there are any additional tools Congress can provide OCRM as it works to continue strengthening the 7(a) loan program.

Again, I want to thank the witness for being here today, and I now yield to the Ranking Member, Mr. Chabot, for his opening statement.

Mr. CHABOT. Thank you, Madam Chair. And thank you for holding this hearing.

Financing for a small business, entrepreneur or startup is the fuel that turns the Nation's economic engine on and propels it forward. It can be the key to transforming an idea into the next great American product or service.

Unfortunately, as our economy moves forward, access to capital remains one of the top challenges for the Nation's job creators. When financing options are limited, small business have the option of turning to the SBA, the Small Business Administration, and its numerous lending programs. These public-private partnerships offer government guarantees based upon a multitude of factors. Annually, these programs provide capital assistance to small businesses all across the country, including in America's greatest state, Ohio.

However, with any Federal Government program, vigorous and comprehensive oversight is mandatory to safeguard American taxpayer dollars.

While this Committee conducts congressional oversight, the SBA also dedicates an entire operating unit to this endeavor. The Office of Credit Risk Management is charged with overseeing lending partners and monitoring program risk. Last Congress, the Chairwoman and I led efforts to codify this office and to ensure that it remains a top priority moving forward.

That is why it is critically important that the office's director is testifying today. I am looking forward to a productive conversation that examines each program's performance and each program's risk. Additionally, I would like to hear how last Congress's oversight bill has been implemented and whether it has provided the tools necessary to access and to assess and guard against risk within the 7(a) loan program.

Each program is unique. Thus, each program requires its own specific oversight plan. I am looking forward to examining each program at this hearing. The timing of this hearing is fortuitous because in the coming days we will receive the President's budget and each agency's congressional budget justification which will include fiscal year 2021 requests. These important documents add another layer to the monitoring of these programs.

I know this Committee would like to continue to work with the SBA to ensure these programs run effectively and efficiently on behalf of the small businesses that truly need the SBA's services.

I want to thank the witness for joining us this morning. I welcome the conversation, and I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Thank you, Mr. Chabot. The gentleman yields back.

If Committee members have an opening statement, we would ask that they be submitted for the record.

I would like to explain the timing rules. The witness gets 5 minutes to testify and members get 5 minutes for questioning. There is a lighting system to assist you. The green light comes on when you begin, and the yellow light means there is 1 minute remaining. The red light comes on when you are out of time, and we ask that you stay within that timeframe to the best of your ability.

I would now like to introduce our only witness today.

Our witness is Susan Streich. Susan joined the SBA in 2016 as Director of the Office of Financial Program Operations, part of the Office of Capital Access. She became director of the Office of Credit Risk Management in 2017. Prior to joining the SBA, Susan spent her distinguished career engaged in SBA lending, working with a diverse array of financial services organizations, including a 7(a) bank, a CDC delivering the 504 program in Arizona, and a small business lending company with a national footprint. More recently, Susan served in senior consulting roles with Booz Allen Hamilton and NFI Consulting, leading projects with USDA's Office of Rural Development and the U.S. Treasury's CDFI Fund.

Ms. Streich, you are now recognized for 5 minutes. Thank you for being here.

STATEMENT OF SUSAN E. STREICH, DIRECTOR, OFFICE OF CREDIT RISK MANAGEMENT, UNITED STATES SMALL BUSINESS ADMINISTRATION

Ms. STREICH. Thank you, Chairwoman Velázquez, Ranking Member Chabot, and members of the Committee for inviting me to speak today. It is my pleasure to appear before you as we start this new calendar year.

As director of SBA's Office of Credit Risk Management, or OCRM for short, I am responsible for the oversight of lenders participating in the Small Business Administration's business loan programs.

I bring to this position over 37 years of lending experience and a commitment to the small business community and the lending partners that serve them.

In 2016, I was selected by SBA to serve as director of the Office of Financial Program Operations in the Office of Capital Access. While in that position, I successfully oversaw SBA's loan origination servicing and liquidation operations. In 2017, I became the acting director of OCRM, and was made permanent director 3 months later by then-administrator Linda McMahon.

OCRM is responsible for developing and implementing effective risk management practices and overseeing SBA loan programs and lender participants. The four main responsibilities of my office are to provide lender oversight, monitor the entire 7(a) and 504 loan portfolios for performance, administer enforcement and supervision of SBA approved lenders, and when necessary, suspend or debar program participants.

In 2018, Congress passed the Small Business 7(a) Lending Oversight Reform Act, which statutorily codified the existence and responsibilities of OCRM.

I want to thank Congress, and particularly the members of this Committee, for their work on this very important legislation.

The 2018 legislation required SBA to promulgate regulations to implement certain provisions of the law. The agency has pursued this rulemaking in a diligent manner and published the proposed Lender Oversight Rule in June 2019, 1 year following enactment of the law. The final rule is expected to be published by the end of the month.

Over the last 2 years, OCRM has also been seeking ways to better fulfill its mission while adapting to the current lending environment. OCRM has accomplished this by improving its operations, as well as by bringing on additional staff.

In 2019, OCRM implemented nationwide expansion of the Lender Oversight Pilot Program so that one team is overseeing all federally regulated 7(a) lender participants. This national rollout created a consistent review methodology across the Nation, improving lender oversight and resulting in a more robust, effective and efficient lender review process. This program enhancement was coupled with a renewed focus on customer service with program participants.

OCRM is increasing its number of personnel from 36 to 42 staff members in order to better fulfill its mission. OCRM has built strong and collaborative relationships with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency as part of its lender oversight activities. These partnerships with the primary Federal regulators for lenders have enabled OCRM to fulfill its mission and enhance its effectiveness in providing lender oversight of SBA program participants.

I want to briefly touch upon the report that SBA's Inspector General released in 2019 regarding the oversight of high-risk lenders. The report covers lender oversight practices from 2015 to 2017, which was before I took my role as director of OCRM. The report offers six recommendations to improve oversight activities. We are in the process of addressing those recommendations and will continue to address the concerns raised in the report.

Finally, I want the Committee to know that OCRM is pursuing several significant goals during the current fiscal year to improve its ability to proactively monitor portfolio performance and identify and mitigate lender risk. These include adding microloan intermediary oversight capabilities by the end of this fiscal year; publishing the final lender oversight rule by the end of next month; revising our two OCRM SOPs, SOP 5053, which is the Supervision and Enforcement SOP and SOP 5100, which is our examination manual; and continuing to enhance our partnerships with the FDIC and OCC.

Thank you, Chairwoman Velázquez and Ranking Member Chabot, for inviting me to testify here today. I look forward to answering your questions and continuing our work together with you to ensure proper oversight of SBA loan programs.

Chairwoman VELÁZQUEZ. Thank you, Ms. Streich.

I will begin by recognizing myself for 5 minutes.

Last June, the SBA published a proposed rule to implement the 7(a) Lending Oversight Reform Act. The agency received 35 comments from the public in response to the proposal. Can you describe the nature of the comments OCRM received in response?

Ms. STREICH. Thank you. Okay, sorry.

I do not have that information, that level of granularity with me today. I would be happy to get that for you if you would like.

Chairwoman VELÁZQUEZ. Sure, thank you.

I am happy to hear that the rule will be published at the end of this month. Will the rule be significantly different from the proposed rule, the final rule?

Ms. STREICH. No. Not in my estimation. Not significantly different.

Chairwoman VELÁZQUEZ. Okay. The IG has an ongoing high-risk 7(a) loan review program to see if high dollar 7(a) loans that defaulted early were originated, closed, and complying with SBA's rule. The IG has identified numerous such loans that have created a considerable credit risk to the agency. What specific action items are you taking to make sure noncompliant lenders are held accountable?

Ms. STREICH. So Chairwoman Velázquez, the primary responsibility for that activity actually resides with my former team, the Office of Financial Program Operations, and they work closely with the OIG on those issues throughout the year and try to resolve them as quickly as they can.

Now, how it impacts OCRM, as we are involved in lender oversight and reviews for those lenders that have actually originated those loans, we are looking and collaborating with our team members over an OFPO to see how we can actually build upon what they are learning and make sure that we are collaborating and learning from one another how we can help coach that lender into doing the right thing from a compliance standpoint going forward.

Chairwoman VELÁZQUEZ. The Oversight Act gave you additional tools to deal with program violations. How, and how often have you used them?

Ms. STREICH. We have approximately, in a variety of ways, ma'am, we have approximately 40 lenders on the watch list, which means that they are under increased supervision. That list changes almost monthly depending upon——

Chairwoman VELÁZQUEZ. What type of supervision? Are you coaching them? Informal mechanism or——

Ms. STREICH. It involves everything from voluntary agreements with them to stand down on use of delegated authority or PLP authority, to standing by on sale of any loans in the secondary market without our view and permission of each and every loan transaction. So, it can be a pretty significant impact on those lenders. Many of those lenders are under orders from their primary federal regulators.

And then we have additional informal and formal actions under way right now. I cannot be specific as to what they are as you might know because they are confidential. And we have additional supervision actions that we take, including when we are conducting a review of a lender and we have concerns about the performance that is exhibited both operationally for them and in deficiencies in the loan review process. We will call them in to headquarters and have a conversation with them and give them some kind of an action plan to work with us on.

Chairwoman VELÁZQUEZ. How many lenders are you dealing with in this category?

Ms. STREICH. Probably close to 125 at this point in time.

Chairwoman VELÁZQUEZ. Ms. Streich, as you may know, earlier this summer an SBA loan broker pleaded guilty to SBA loan fraud amounting to more than $100 million and was sentenced to prison for 9 years. Back in 2013, a codefendant was sentenced to 15 years and ordered to pay restitution of $91 million. Clearly, keeping track of loan brokers and agents like this is a challenge for the SBA. How effective is the current mechanism for tracking loan brokers and agents? Please comment on its effectiveness.

Ms. STREICH. Thank you, ma'am.

Two things to think about here. One is that I am the suspension and debarment agent's agent for the SBA for all financial programs. I have the ability with OIG and OGC participation to take suspension and debarment actions against individuals that have received convictions or even indictments that we are concerned that should get out of the lending industry entirely. And we do take those actions regularly.

Chairwoman VELÁZQUEZ. Have you taken such actions?

Ms. STREICH. Yes. Yes.

The risk that loan agents pose to the agency is something that we are constantly monitoring. About 11 percent of the portfolio in 7(a) has been generated through loan agent activity. We work closely as the FDIC and the OCC guidance has been provided to their lenders. We work closely with the lenders involved that have those contractual relationships with loan agents, and we work with them to see how they are managing the third parties that they retain, including loan agents. When we have an upcoming review of a lender, we ask them if they have third parties involved in their SBA loan operation at any stage. If we do find out that they do have third parties, we get copies of the loan agreements that they have, the contracts that they have with those agents. We review those as part of our overall review, and then for each one we ask them to complete a nine-page questionnaire to give us much more detail about what is going on with that lender relationship and what services they provide. That gives us a great deal of information. That just began about the last 6 months so we do not have lots of comprehensive data yet, but we are gathering it in hopes that it will give us insight into how we can manage that and monitor that more closely.

Chairwoman VELÁZQUEZ. So last point.

Ms. STREICH. Yes,

Chairwoman VELÁZQUEZ. Do you have enough staff to keep track of loan brokers?

Ms. STREICH. Ma'am, I think it depends on what you mean by "keep track." In terms of monitoring the risk on the portfolio and the performance for lenders, yes, at this point we do.

Chairwoman VELÁZQUEZ. Okay.

Now, we recognize the Ranking Member.

Mr. CHABOT. Thank you, Madam Chair.

Thank you for being here today, Ms. Streich.

As you know, Congress passed, and President Trump signed into law the Small Business 7(a) Lending Oversight Reform Act in the last Congress. While there are many provisions in the law that strengthen the SBA's ability to oversee risk, I want to touch on just one that is essential for the program to serve small businesses that truly need the SBA's resources.

Could you walk the Committee through the credit elsewhere test and how your office monitors that?

Ms. STREICH. So the legislation that you passed last year and I would expect we will see something like this in the rule, and we have SOPs that designate what the credit elsewhere rule means and how lenders comply with it. And it is very specific in the SOP 50 10(5)(K). And we apply and interpret that in our reviews of lender files so that we can determine whether or not they are actually maintaining compliance with credit elsewhere.

The challenge with credit elsewhere, frankly, has been that we do not have an easy, automated, electronic solution at this point in time to check the box and determine how many of each reason for credit elsewhere not being available the lender may have actually checked. So, it is a bit of a manual exercise for us right now in the loan review process.

Just to give you an idea of the volume of loan files that are reviewed, the federally regulated team reviewed 2,000 loan files last fiscal year, and that did include the SBA supervised loan files that were reviewed, each and every one. We are manually keeping that information on spreadsheets at the moment in hopes that eventually we will be able to actually have a database that we can include that information on and make it easier to query and gather that information and share it with you more specifically.

Mr. CHABOT. Thank you.

How often does it occur that lenders violate the credit elsewhere test?

Ms. STREICH. It is interesting that you would ask that. We had a meeting about this just the other day, wrapping up 2019 reviews, some of which the reports, or some of them are still getting completed and getting out. And we only have one lender in all of 2019 that really, in your opinion, was egregious with regard to not documenting credit elsewhere to our satisfaction, and we have talked to that lender.

Mr. CHABOT. That is good to hear. Thank you.

Congress was notified this time last year that the 7(a) loan program required a $99 million subsidy to continue operating in fiscal year 2020. In the coming days we are set to receive the fiscal year

2021 number. Will the 7(a) loan program and/or the 504 CDC loan program require a subsidy moving forward?

Ms. STREICH. I am sorry; I will not be able to answer that question. The Office of Capital Access and OCRM are not involved in determining what the subsidy model components are and how it is going to be developed. That really resides with our OCFO office.

Mr. CHABOT. Expecting, anticipating that answer, let me ask the question in another way.

How have the 7(a) loan program and the 504 loan program performed this year compared to last year?

Ms. STREICH. So I would say that overall the entire portfolio is performing well, both in 7(a) and 504. 504 defaults are at a remarkable low level, remarkably low level. 7(a), we have seen early defaults in 7(a) creeping up slightly year over year, but not changing dramatically and are not presently a cause for concern.

Mr. CHABOT. Okay. Thank you.

As you stated in your testimony, the SBA lending programs are reserved for "creditworthy small businesses that otherwise would not be able to access capital to start or expand their business."

We want to continue to work with your office to ensure the appropriate small businesses have access to these programs. What, if any, additional tools do you think that you might need at your disposal to meet this mission? Anything come to mind?

Ms. STREICH. Thank you very much for asking.

I think at this point we are still trying to digest all the changes that have come about because of the act that you all were so wonderful to provide for us and the additional authority provided to us. We are actually also making changes organizationally and functionally to make sure that we can do everything from a regulatory standpoint that we are changed with and do it well. Obviously, interest and sustaining a program integrity for the long term and serving the needs of the small businesses who really need access to capital. So, I think we need a little more time to digest everything before I can recommend anything new that we might need in terms of authority.

Mr. CHABOT. Thank you very much.

Since I am in single digits as how much time I have left, I am going to yield back rather than go over here. Thank you. I yield back.

Chairwoman VELÁZQUEZ. Thank you. The gentleman yields back.

Now we recognize the gentleman from Pennsylvania, Mr. Evans, for 5 minutes.

Mr. EVANS. Thank you, Madam Chairperson.

For the 7(a) loan program, SBA is not the direct lender. Instead, it relies on private sector lenders, and these private sector lenders are mostly banks. But it also includes small business lending companies. FinTech lending has become increasingly popular for small businesses looking for loans. Are there any plans for the SBA to engage with FinTech lenders, and do you think it should?

Ms. STREICH. Thank you for the question. I appreciate it very much.

We have talked to a number of FinTech lenders through the course of the last couple of years. There is not an easy relationship between what they do and what we do at this point in time, but we are learning from one another. And the result of just that concept of quick decisioning and Internet-based applications has helped foster the lender Match program at SBA. You may have heard about that. It is an online application that is actually free to the borrower or the proposed borrower and enables a number of lenders participating in the 7(a) program to review applications that come in right to the SBA website. It is a very successful program. It is actually going forward and being improved now. And by the end of, I believe, March, we are going to have a Spanish version of Lender Match.

Mr. EVANS. So you are going to engage with FinTechs?

Ms. STREICH. It is a very similar approach to the FinTech solution because it is an Internet-based application. Yes, that is similar. We not really working one of the FinTechs to do this, however.

Did I answer your question, sir?

Mr. EVANS. Yes, you did.

Ms. STREICH. Okay.

Mr. EVANS. In your written statement you said that your office participates in informal and formal enforcement actions, including volunteer agreements and suspensions from participation in SBA programs. How many enforcement actions did your office initiate in 2019? And what were the nature of these actions?

Ms. STREICH. In 2019, we had informal and formal enforcement actions. I think it was five. We have since then taken additional actions in fiscal 2020 and we are continuing to be rigorous in our approach to suspension and enforcement activities. The informal activities generally involve calling a lender into a headquarters meeting, which is actually a very serious occasion wehore we sit down with them and we ask them if they understand why they are not compliant with our requirements and what we can do to get them on track. We want them on a compliant path, obviously, to go forward.

And then secondly, we have voluntary agreements. So if it is a PLP lender, a preferred lender that has delegated authority, we will ask them to please stand by in delegated authority and submit all of their loan applications to the center in Citrus Heights for their review, underwriting, and approval. So, we can track through the center how they are performing in terms of application activity. Are their applications complete? Do they really catch everything from a credit administration standpoint in the credit memo? Do they follow up and abide by the credit elsewhere criteria? All of that can be checked by the center and they feed that information back to us. When we think that they have solved their problems and they are performing well, then we are willing to let them use delegated authority again, but not until then.

Mr. EVANS. This is somewhat of a piggyback on the Chairwoman's question earlier about resources. The 7(a) loan program has made rapid growth in recent years, and in fiscal 2012, the program approved $15.2 billion in loans. By fiscal 2017, that number increased to $24.5 billion.

Ms. Streich, how has your office adapted to this rapid growth? And does it need additional resources to provide effective oversight of credit risk?

I think what I heard you when you were responding to the Chairwoman, you said, kind of gave an answer that was not that clear to me.

Ms. STREICH. Okay. Happy to have to provide additional information.

We have a great data warehouse called the Loaner Lender Monitoring System, LLMS for short. It is managed for us by Dun & Bradstreet. And that system provides great data analytics for us to measure performance by loan, by loan segment, by industry, by industry type, by geography and a variety of other segmentations that we can perform of the portfolio to identify where risk is in the portfolio, where emerging risk may be, and then what we need to do to mitigate it. So that information is readily available from LLMS. And we use that information weekly, monthly, quarterly, semi-annually, and annually in intense deep drives into certain aspects, segments of the portfolio give us great data to use to determine what kind of course of action we as a risk identifying and mitigating group have to proceed to make sure that we have managed risk in the portfolio for 7(a).

Did I do a better job of answering that question?

Mr. EVANS. I yield. Yes.

Chairwoman VELÁZQUEZ. The time has expired.

Mr. EVANS. I yield, Yes. Thank you.

Chairwoman VELÁZQUEZ. Now, we recognize the Ranking Member of the Subcommittee on Economic Growth, Tax, and Capital Access, the gentleman from Oklahoma, Mr. Hern.

Mr. HERN. Thank you, Madam Chairwoman, Ranking Member Chabot.

Director Streich, thanks for being here.

As the Ranking Member of the Small Business Committee, Subcommittee on Economic Growth, Tax, and Capital Access, I understand the need for small businesses and entrepreneurs to obtain access to capital. Additionally as a founder of a small community bank, I also understand that heavily financial risk involved with lending and loan programs such as this, sort of a loan of last resort, if you will, I have experience with both the banking and the business side. I find that it is essential that we have the necessary checks and balances in place to ensure that the SBA's loan programs are being properly executed and that the government is not being taken advantage of due to lack of oversight. So, thank you.

As you know, the 7(a) loan program gives small businesses the opportunity to gain access to capital who often do not have the capacity to gain funding on their own. This successful program has provided nearly 52,000 loans for small businesses and entrepreneurs across the country, and the program operates by taking fees which allow the SBA to run the loan program efficiently while also protecting our taxpayers.

These built-in fees meant to cover all program costs have been sufficient until recently as the 7(a) program claimed the need for a $99 million subsidy in fiscal year 2020.

As someone who has successfully managed budgets his whole life this was very concerning. It was concerning for every member on the panel, the Chairwoman, both sides of the aisle here. To go from self-sufficiency to reliance on a $99 billion subsidy leaves me with numerous questions including the following.

And I appreciate it. I have been listening to you for short minutes here and you have got answers. When your former CFO was here, he seemed not to have any answers to the tough questions, so thank you for coming prepared to answer questions today.

Director Streich, what performance characteristics contributed to the 7(a) loan program needing subsidy? Was it performance decline? What are you seeing today? You have described some of those as I was walking in here. Could you talk to us about what are you needing?

Ms. STREICH. So, Congressman, I do not have specific information into the components, into the subsidy model that was created by our OCFO office in conjunction with OMB. That information is closely held, and they segregate that away from those of us that actually are involved in the capital access for purposes of, you know, making sure that——

Mr. HERN. But you are in credit risk——

Ms. STREICH. Right.

Mr. HERN. And I do not want this to be confrontational, but you are in credit risk. So, you look at a lot of actuarial data, historical data. We do not ever throw that away. You described a growing economy. You described a default rate that you are collecting your monies. And so, it is hard for us I think, I do not think most members' thoughts have changed on this because we have not had anything to change it. The economy has even gotten better. We have not heard a lot, or anything about business failure. So, what, in your assessment of credit risk, there has to be some thoughts about what would go on to drive this need for extra money to some mythical credit risk.

Ms. STREICH. So let me go back to my banking and lending days and running a SBA loan production center, and talk to you about just the countercyclical nature of SBA loans because I think that will be helpful.

During the Great Recession, SBA lending really took off and we put in the portfolio a lot of really high creditworthy borrowers because the banks and others, as you might recall, stopped doing lending almost entirely. So, the only way some of these borrowers could get money was through the SBA loan program.

As a result, with the economy being strong, those loans performed really well. Now, those loans are refinancing and going conventional because the conventional credit box during a strong economy has actually been opened up as a lender. If you have a conservative credit box during tough times, you have a more open credit box as you probably did at your community bank during good times. And as a result, more loans are going through that process conventionally, which is really the purpose of the program. And then we are getting loans that may be a little higher risk and falling outside of the conventional, the new conventional credit parameters.

Mr. HERN. If I may stop you because I have got one other question, but I like the word you just put in there, may be. They have not proven to be, and so they are not based on really historical facts. They are based on presumption. And so, we have not seen that yet.

Let me ask you this last question before we lose our time here.

As a result of the 7(a) loan program having a subsidy, what has your office done to ensure taxpayer dollars are being protected moving forward?

Ms. STREICH. So we identify through each of our lender reviews targeted and full reviews, we pull credit files, loan files from the lenders and we review each and every page of each and every file, usually thousands of pages, to make sure that they are being compliant with SBA's requirements. If we identify deficiencies during those loan file reviews, we communicate that information back to the centers that are involved in the operations side, the origination and the Guaranty Purchase Center. Through the cron, which is an electronic communication tool, we tell them where to focus their attention. If that loan goes into default and ends up with a purchase request to honor the guaranty, the NGPC, which is the National Guaranty Purchase Center in Herndon, then that financial analyst that pulls that information up on the cron can go right to that part of the file, identify whether there is a deficiency that is material, and if so, can either repair or deny the guaranty. That enables us to make sure that we are not providing taxpayer dollars unnecessarily and inappropriately to a lender who has done the wrong thing.

Mr. HERN. Thank you.

Madam Chairwoman, if I may, I would like to recognize the fact that the SBA sent somebody that actually has answers to some of our questions. I really appreciate that. This is a refreshing follow up to the former member that was here. Thank you.

Chairwoman VELÁZQUEZ. Thank you.

Time has expired. Now we recognize——

Mr. CHABOT. We do not complement witness around here that much, so that is pretty good.

Mr. HERN. That is a rarity. Thank you.

Chairwoman VELÁZQUEZ. The gentleman from Illinois, Mr. Schneider, for 5 minutes.

Mr. SCHNEIDER. Thank you, Madam Chairwoman. Thank you for having this hearing.

Ms. Streich, thank you for being here. I will echo the comments of my colleague, Mr. Hern. I think that is important.

He was touching on some important issues. As you related, the countercyclicality of the portfolio within the SBA. And as the economy is growing, access to capital is still critically important, especially for small businesses who enter conventional lending markets to tell their story. Often, they may not have the track record of a larger business or a more tenured business. It is a startup. And so, these opportunities are vitally important to continue to grow our economy.

At the same time, while I think it is important that SBA lending be easily accessed, efficient, effective, we need to monitor and manage the credit. As you were implementing the recommendations of the OIG report as you look to the future what are some of the key things that we need to do to make sure that we are protecting against in appropriate risk, identifying and addressing when lenders are behavior inappropriately, but making sure that we maintain that access for small businesses to get the capital they need to grow their businesses.

Ms. STREICH. That is a great question. One of the challenges that we are working with across all of our capital access team, especially our Office of Financial Assistance and our Office of Financial Program Operations is what kind of additional training we can provide to lenders on a regular basis through our district offices, through the Office of Field Operations, as well as directly. We did 16 conferences last year alone, both at district level, regional, and trade associations. We do webinars regularly. The whole goal is to make sure that lenders do not do the wrong thing. Do not make a misstep. There is nothing worse if you are a small business person relying upon your bank to be judicious in the amount of credit they are willing to give you than to have them give you too much, you cannot afford to repay it, and all of a sudden then you are in trouble.

Mr. SCHNEIDER. Right.

Ms. STREICH. Right? So, we used to say, very similari to the medical community, at first, do no harm. Right? And so, one of the things that we have seen in our reviews of certain loan files for certain lenders this last year, is that, in fact what is happening in part is smaller transactions are being overfunded. And as a result, the borrowers are not able to repay that entire amount. They probably could have gotten away with significantly less money and it would have been much more affordable for them. So it is our job, in part, to make sure that we are working with the trade associations and the districts and all other opportunities to provide that kind of insight and feedback to the lenders to get them to make sure that they are actually making good, judicious credit decisions.

Mr. SCHNEIDER. I think that is important. Oftentimes here we are talking about unconventional ideas, unconventional risk. That does not mean they are inappropriate, that does not mean they are outside the range of what is an acceptable risk. But if you take them too far, I like to say, I grew up near the mountains and I am very comfortable driving on mountain roads. I tend to keep both wheels on the road and in the center. I try not to go too far to the edge, and that is what I want these small businesses to be able to do, is to take the risk, to make the ascent, but to do it in a way that is supported by the lender. So, I think it is important to communicate that.

Taking that a step further, how do we make sure that—and this may be outside your role—that the lenders are getting out to the marketplace so that small businesses understand what is available to them. That there is an opportunity to get capital, to fund their ideas and invest in their business, but to do it in a way that is prudent and appropriate for them.

Ms. STREICH. That is an interesting question.

When I started in this business, in 1981, as a 503 lender, nobody knew what SBA was, but they were horrified that they might, as a small business borrower, need to access any capital through the SBA. It was a terrible reputation. So, we had to try to figure out how to sell everything by developing some kind if credibility with the small business borrower first.

That is not true today. Today, wherever I go, I like to talk to entrepreneurs—restuarants, my physical therapy office—I like to ask them, you know, how did you get to this point? And I love hearing them say, well, I got an SBA loan. And then I always ask them from whom? Because I just like to know who is active in each marketplace. And I just think it just speaks to the fact that many lenders really like this program. And they really are out there offering it to the marketplace in a very active way. That is wonderful. They are an adjunct to our educational opportunity for the marketplace.

Mr. SCHNEIDER. And just to close, I am a little bit past my time, but the role that we can play as members of Congress engaging in our community, we have seminars, roundtables. We bring entrepreneurs together to say, hey, we can make a difference, and I look forward to continuing that.

I yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentleman from Tennessee, Mr. Burchett, for 5 minutes.

Mr. BURCHETT. Thank you, Chairlady, Ranking Member. It is always a pleasure being here, ma'am. And thank you, ma'am, for being here with us.

Let me make sure I have got the name right. Streich. Is that how you say it?

Ms. STREICH. Just like strike three and you are out. Yes.

Mr. BURCHETT. All right. Well, Burchett. Just like the tree, birch like the tree, and ett like I just "ett" lunch. Which I did not, but the Chairlady always promises me she is going to bring me a meal, but she never does, so anyway. That is just what happens here in Congress, I guess.

Does the Office of Credit Risk Management need any additional oversight tools to further protect our taxpayer dollars within the microloan program? And if so, what would you request?

Ms. STREICH. That is a great question. I cannot answer it today. We have as our goal to take on microlender oversight in 2020 but we are just starting to recruit for that position, and we will be taking over the oversight that the program office has been engaged in heretofore. So, in another 3 to 6 months I will be able to probably answer that question much better than I can today.

Mr. BURCHETT. Okay. That was an honest answer. So, thank you.

Let me ask you one more. What is the current oversight plan that the Office of Credit Risk Management has in place to oversee the microloan program?

Ms. STREICH. So microlenders, as you know, are intermediaries for us. We provide a loan to them and they actually provide the loans to microlending opportunities, and they are usually within their community. And they do that very well. Their performance overall has been very stellar in terms of their portfolio. And what we want to be able to do is examine what they are doing, make sure it is compliant with any requirements that the SBA has for their performance, and make sure that they are servicing those loans very, very well and diligently. And if we request information or access to their files that they will allow us to have a chance to look at them. Very basic.

Mr. BURCHETT. Thank you, ma'am.

Chairlady, Ranking Member, I yield back the remaining 2 minutes and 59 seconds of my time. Please use it wisely as I know you will.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentleman from Maine, Mr. Golden, for 5 minutes.

Mr. GOLDEN. Thank you, Madam Chair.

Director Streich, thank you for being with us today.

I want to follow up on an earlier conversation you were having. Does SBA assign loan brokers and agents with unique identifiers to systematically track their activity?

Ms. STREICH. Not at this time. No, sir.

Mr. GOLDEN. And would there be any benefit to your office in carrying out your role if you were to do that?

Ms. STREICH. I do not believe so at this time. We have a variety of tools available to us to track loan agent performance by lender that they have relationships with. One way is through the review process, and we ask the lender to provide a great deal of information, including the agreements that they have with those loan agents. We review those and see what kind of relationship there is and what kind of services are provided and what kind of fees are being charged and to whom. We also have the Form 159, which is a form that really gives us a great deal of information for any fees that are charged during the course of a loan origination, whether it is by the lender or by a loan agent. And we use that information and are just starting to aggregate that so we can determine and monitor loan agent risk and performance of each individual loan that they have referred into a specific lender. If we see that there is a trend that a lender specifically with a relationship with a loan agent is experiencing challenges with their portfolio performance, then we are talking to them about why they are continuing to accept referrals from that loan agent if, in fact, their performance is less than adequate.

Mr. GOLDEN. You have a good level of confidence that you are pulling in the information that you need to have visibility and that it is compiled in a way that is easy for you and your staff to put it to good use?

Ms. STREICH. Well, we are certainly getting the information. We are still working on the best way to compile it and access it so that it is easier to automate and electronically available to us.

Mr. GOLDEN. Thank you very much.

Chairwoman VELÁZQUEZ. Well, Ms. Streich, thank you very much. It is like a breath of fresh air to bring someone from the Administration, at SBA, that really provides the facts and is able to provide the answers to our questions. I really feel confident that you are doing a very good job. Thank you.

We have now learned more about a key function of the SBA's capital access programs and one without which the programs could function effectively. However, we have also learned that there is more work to be done towards ensuring proper oversight and accountability over SBA's partner lenders. If we intend to continue enhancing access to affordable capital for small businesses, it is clear SBA's Office of Credit Risk Management will be a key stakeholder.

I look forward to working with my colleagues from across the aisle as we continue to work to enhance the efficiency of SBA's operations and more broadly, to continue enhancing access to capital for America's small businesses.

I would ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

If there is no further business to come before the Committee, we are adjourned. Thank you.

[Whereupon, at 12:25 p.m., the Committee was adjourned.]

APPENDIX

U.S. Small Business Administration

Statement of Susan E. Streich
Director, Office of Credit Risk Management
U.S. Small Business Administration

before the
House Committee on Small Business

Hearing on "SBA Management Review: Office of Credit Risk Management"

February 5, 2020

Statement of Susan E. Streich
Director, Office of Credit Risk Management
U.S. Small Business Administration

Thank you, Chairwoman Velázquez, Ranking Member Chabot, and members of the committee for inviting me to speak with you today. It is my pleasure to appear before you as we start the new calendar year.

The Small Business Administration (SBA) provides access to capital and resources to credit-worthy small businesses that otherwise would not be able to access capital to start or expand their business. These 30 million small businesses support over 58 million jobs. As Director of SBA's Office of Credit Risk Management (OCRM), I am responsible for the oversight of the lenders participating in SBA's business loan programs.

I bring to this position over 37 years of lending experience and a commitment to the small business community and the lending partners that serve them. My background includes extensive experience working with a diverse array of financial service organizations. I started my career with an SBA Certified Development Company in Arizona and later served as president of a Small Business Lending Company (SBLC) headquartered in South Carolina. In 2000, I returned to Virginia to join Capital One, which became the third largest SBA 7(a) lender (in number of loans), funding approximately 5,500 SBAExpress loans in one year.

In 2016, I was selected by SBA to serve as Director of the Office of Financial Program Operations (OFPO) in the Office of Capital Access. While in that position, I successfully oversaw SBA's loan servicing and liquidation operations. In 2017, I became the Acting Director of the Office of Credit Risk Management in the Office of Capital Access and was made permanent Director three months later.

The SBA's Office of Capital Access administers three loan programs for businesses – the 7(a) Guaranteed Loan Program (which includes the Community Advantage Pilot Loan Program), the 504 Program, and the Microloan Program. Each of these programs is dependent on the participation of private sector lending partners who are required to comply with SBA's Loan Program Requirements. The mission of the Office of Credit Risk Management is to ensure the integrity and to maximize the effectiveness of SBA's lending programs by managing portfolio risk, monitoring lender performance, and enforcing lending program requirements.

OCRM currently monitors the performance of over 3,500 7(a) and 504 lenders. These lenders include SBA Supervised entities – Small Business Lending Companies (SBLCs), Non-Federally Regulated Lenders (NFRLs), Certified Development Companies (CDCs), and Community Advantage lenders, and federally regulated institutions, whose primary federal regulator is either the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Federal Reserve, the Farm Credit Administration, or the National Credit Union Administration (NCUA). Approximately two-thirds of these lender participants are classified as "active lenders," which have portfolios in excess of $10 million and have made at least one loan in the last 12 months. These lenders require regular and consistent oversight, with at least one Risk Based Review every 24 months. Those classified as "inactive" have existing loan portfolios that require monitoring to ensure compliance with SBA servicing and liquidation requirements.

In 2018, Congress passed the Small Business 7(a) Lending Oversight Reform Act of 2018, which statutorily codified the existence and responsibilities of OCRM. Growth in 7(a) lending precipitated this legislation, which strengthens SBA's lender oversight authorities, including its ability to supervise its lenders and take informal enforcement as well as formal enforcement action against lenders. The legislation directs OCRM to evaluate participants' conduct in complying with SBA's Loan Program Requirements and, when necessary, recommend and implement enforcement actions against lenders that are putting SBA loan programs at risk.

Informal enforcement actions are usually instructive in nature, involving cooperation from the program participant. They consist of, for example, voluntary agreements or mandatory training. Formal enforcement actions may include imposition of a portfolio dollar ceiling, suspension from secondary market sales, suspension or revocation of delegated authority, suspension or revocation of participation in the SBA programs, or debarment. OCRM recommends the type of enforcement action based on the severity and/or frequency of the violation and enforcement may include a civil monetary penalty. OCRM's recommendation for enforcement action is made to SBA's Lender Oversight Committee, a high level committee that approves, disapproves, or modifies the recommendation.

The 2018 legislation required SBA to promulgate regulations to implement certain provisions of the law. The Agency has pursued this rulemaking in a diligent manner and published the proposed Lender Oversight Rule in June 2019. The final rule is expected to be published next month.

To fulfill its responsibilities, each year OCRM staff perform approximately 1,000 multi-level lender compliance and Risk Based Reviews and an additional 1,100 delegated authority reviews. A key provision of the 2018 legislation and the proposed regulation is that SBA staff must take the lead in all lender reviews. This was not the case historically, as OCRM often engaged contract staff to perform the lead role in lender reviews. Following the legislation, OCRM has begun increasing its staff, modifying its lender review processes, and implementing a rigorous training program to ensure that OCRM has the workforce capability and leadership in-house to support its heightened mission and responsibilities.

OCRM is responsible for developing and implementing effective risk management practices and overseeing SBA loan programs and lender participants. An important component in this ongoing assessment of risk is the administration of the Loan/Lender Monitoring System (known as L/LMS). This system, which was developed by Dun & Bradstreet, enables OCRM to conduct a continuous, risk-based analysis of its portfolio and SBA's lending partners. The analysis features a risk framework for the 7(a) program known as "PARRiS." PARRiS is an acronym for the specific risk areas or components that SBA reviews: Portfolio Performance; Asset Management; Regulatory Compliance; Risk Management; and Special Items. The risk framework for the 504 program is known as "SMART." SMART is an acronym for the specific risk areas or components that SBA reviews for the 504 program: Solvency and Financial Condition; Management and Board Governance; Asset Quality and Servicing; Regulatory Compliance; and

Technical Issues and Mission. Utilizing the advanced analytical data derived from L/LMS, OCRM assesses the performance of each lender and the overall SBA loan portfolio, identifying trends, and analyzing specific segments for deeper review.

Through trend analysis and assessment of analytical risk indicators, OCRM gains insight into risk and more fully evaluates lender and portfolio performance. Based in part on the data derived from L/LMS and the additional analysis performed, OCRM conducts strategic reviews of lending partner activities including their SBA lending operations and compliance with program Standard Operating Procedures (SOPs), rules, and regulations. In addition, Lending Partners have online access to their risk and portfolio performance information through the Lender Portal. This access provides transparency and enables lenders to be proactive in improving performance and reducing risk.

The oversight of our lending partners and risk analysis of SBA's loan programs are critically important to maintaining program integrity. OCRM strives to help lending partners better understand how best to fulfill the requirements of the lending programs in a way that is beneficial to their small business customers while maintaining compliance with the regulations and SOPs that govern each loan program. The capability and compliance of our lending partners is critical to the efficient delivery and overall success of these programs. Consequently, OCRM has an important role to play in identifying lender training needs and coordinating with other SBA offices and external stakeholders to expand learning opportunities to strengthen lender knowledge, understanding and performance.

Over the last two years, OCRM has been seeking ways to better fulfill its mission while adapting to the current lending environment. OCRM has accomplished this by improving its operations and engaging in interagency partnerships with other federal regulators. In FY19, OCRM was able to build strong and collaborative relationships with the FDIC and the OCC. This partnership has greatly facilitated OCRM's ability to proactively identify risk and will help us improve lender compliance and performance on an ongoing basis.

In addition, in FY19 OCRM implemented nationwide expansion of the Lender Oversight pilot program that was tested initially in the Western Region of the Federally Regulated 7(a) Lender Oversight Team during 2018. This resulted in one team overseeing all Federally Regulated 7(a) Lender participants. This national rollout created a consistent review methodology across the nation, improving lender oversight and resulting in a more robust, effective and efficient lender review process by testing the viability of virtual Risk Based Reviews (RBRs), in which lenders upload loan files to an electronic repository for SBA to review. This change resulted in greater consistency and enhanced quality control of the loan file review process at reduced cost to lender participants.

OCRM continues to refine and streamline its approach to monitoring lender risk through its multi-level review process. The Federally Regulated 7(a) Lender Oversight Team is now positioned to perform reviews every 24 months on all lenders with greater than $10 million in SBA loans, and every 36 months for those lenders with portfolios less than $10 million. The review process has been redesigned so that much of the analysis and loan file review activity is performed virtually, providing more timely feedback to the lenders under review and saving them the cost associated with the onsite review process. OCRM is now pursuing an automated solution to develop the analytical portion of the review, which will enable OCRM staff to perform enhanced analysis and more in-depth reviews.

Finally, OCRM is pursuing several significant goals during the current fiscal year to improve its ability to proactively monitor portfolio performance and identify and mitigate lender risk. These include:

- Implementing a recruitment prioritization plan to fill positions;
- Driving development and implementation of the Loan Review Tool (LRT), a solution accessible by multiple authorized users that will enable consistency in loan file review and results that can be aggregated by loan type or lender segment;
- Adding Microloan Intermediary oversight to FY20 oversight capabilities;
- Publishing the final Lender Oversight Rule;
- Revising SOP 50 53 (Supervision and Enforcement) and SOP 51 00 (Examination Manual); and
- Continuing to enhance partnerships with the FDIC, OCC, and NCUA.

Thank you, Chairwoman Velázquez and Ranking Member Chabot, for inviting me to testify here today. I look forward to answering your questions and continuing our work together to help advance small businesses across this country.

Questions for the Record
House Committee on Small Business
Hearing: "SBA Management Review: Office of Credit Risk Management"
February 5, 2020 | 11:30am | 2360 Rayburn House Office Building

Questions for Ms. Susan Streich, Director, Office of Credit Risk Management (OCRM), Small Business Administration from Chairwoman Nydia M. Velázquez

1. We understand there are ongoing 7(a) portfolio issues that you regularly address as OCRM Director. While most are relatively minimal concerns in terms of the overall stability of the portfolio, I am interested in knowing if there are currently any **systemic** performance problems with the 7(a) portfolio that would be of **serious or grave** concern? If so, what are they? Please describe the magnitude of the issue – for example, the percentage of those problem loans have increased from what percentage to what percentage?

   SBA RESPONSE:
   There are not currently any systemic performance problems with the 7(a) portfolio that are of serious or grave concern. OCRM monitors portfolio performance on a monthly, quarterly, semi-annual and annual basis. 7(a) early defaults have been gradually creeping up month over month since September of 2017 but are not changing dramatically and are not presently a cause for concern.

2. In FY2020, the 7(a) program operated on a positive subsidy. In FY2021, the 7(a) program is once again projected to run on a positive subsidy. This has raised questions regarding the performance of the 7(a) portfolio and the econometric model used to project subsidy, especially since macroeconomic indicators show a strong economy. Based on any behavior in the 7(a) portfolio, do you foresee any issues that would cause serious or grave concerns in the performance the 7(a) portfolio in the near-term future?

   SBA RESPONSE:
   As in the aforementioned response, 7(a) early defaults have been gradually creeping up month over month since September 2017 but are not changing dramatically and are not presently a cause for concern. In December 2018, 7(a) early defaults were .81% of outstandings; in December 2019, they were 1.08%. Based on the loan status and credit scores of the 7(a) loans in the portfolio today, OCRM does not anticipate a significant shift in performance over the next 12 months.

From Ranking Member Steve Chabot (R-OH)

1. How are high dollar loans performing and how are low dollar loans performing? Are there trends that we need to be aware of with these two loan categories when it comes to risk?

SBA RESPONSE:

a. In the 7(a) portfolio, large loans (> $2 million) generally perform best, with an early problem loan rate of 2.17% and last 12 month purchase rate of 1.50%, whereas the smallest loans (≤$150,000) perform worst in terms of early problem loan rate (3.0%) and last12 month purchase rate (2.7%). [**Early Problem Loan Rate --** Gross outstanding balance of young loans (month on book (mob) <= 36) that have experienced a deferred, delinquent (60 or more days past due), purchased, or charged off status when mob <= 18, divided by gross approved amount of all young loans (mob <=36).]

b. By loan size, large loans (> $2 million) make up the largest percentage of the 7(a) portfolio by outstanding balance at 33%. The smallest loans (≤$150,000) make up only 6% of the portfolio. As stated previously, the smallest loans do not perform as well as the large loans.

2. Can you walk the Committee through the onsite and offsite review or exam process for each of the main SBA lending programs? How long do the exams typically take to conduct?

SBA RESPONSE:

7a Federally Regulated:

- OCRM used a FY19 pilot program to develop additional review types and leverage technology, such as inspecting files remotely, to improve resource deployment in support of our mission.

  Lending partners identified for review are vetted to determine the appropriate review type. OCRM currently utilizes five primary review types that range from very narrow scope, such as testing specific SBA Forms, to full scope reviews, which incorporate a wide range of activities including, but not limited to, assessments of individual PARRiS components (OCRM's 7(a) risk rating system), 7(a) management, operations, and oversight, and 7(a) credit administration.

  The review type affects the level of information and documentation that must be provided by the Lender, with time allowances ranging from 5 business days to 30 calendar days. Regardless of the review type, OCRM concludes most reviews within 60 days of a Lender being notified that it is subject to review and review reports are typically issued within 60 days of the exit conference, which is the review's conclusion date.

  If circumstances require additional time to complete the review activities, the Lender is notified of the delay and expected timeline. Delays primarily occur when the Lender's risk profile is elevated (e.g., high risk behavior that poses a reputational or financial risk to the 7(a) loan program) and the Lender is periodically provided status updates until the report is finalized and issued.

Community Advantage Lenders:

For all Community Advantage lenders with at least one Community Advantage loan outstanding, OCRM conducts reviews of the lender's internally prepared quarterly financial statements (including their loan loss reserve account) and annual reviews of their CPA-prepared audited financial statements. In addition, SBA conducts both on-site and off-site reviews of Community Advantage lenders' loan files. On-site targeted loan file reviews are typically 3-5 days (length depends on size of loan sample which is dependent on lender loan size).

Small Business Lending Companies (SBLCs)/Non-Federally Regulated Lenders (NFRLs):

OCRM conducts reviews of the internally prepared quarterly financial statements and annual reviews of CPA-prepared audited financial statements for SBLCs and NFRLs. On-site safety and soundness examinations of SBLCs may be for as short as one week (for smaller-sized SBLCs) and typically are up to two weeks for larger-sized SBLCs. SBA has spent as much as 3 weeks on-site for very large SBLCs when they show specific higher risk characteristics. For NFRLs, depending on size and risk characteristics, we will either conduct an off-site or on-site review, which includes a review of a sample of the NFRL's loans. For on-site NFRL reviews, OCRM is generally on-site for 3-5 days, depending on the lender size and risk.

Certified Development Companies (CDCs):

OCRM conducts a review of all CDC Annual Reports (which includes review of a CDC's CPA-prepared reviewed or audited (audit for CDCs with $30 million or more in 504 loans outstanding, reviewed for those with under $30 million in loans) financial statements annually. In addition, we conduct SMART (OCRM's 504 risk rating system) Full, Targeted, and Analytical Reviews of CDCs on an ongoing basis. In FY 2020, we are scheduled to conduct a SMART Review of over 25% of all CDCs. SMART Full Reviews are conducted on-site, include a review of at least 30 loan files and interviews with CDC Management and Board officials, and usually last one week. SMART Targeted Reviews are normally conducted on-site and include a review of at least 15 loan files. SMART Targeted Reviews typically last 3 days. SMART Analytical Reviews are conducted off-site.

Microloan Program:

SBA annually conducts a one day on-site visit of all Microloan Intermediaries. In addition, SBA conducts a review of each Intermediary's microloan portfolio status, collateral coverage on the SBA debt balance, microloan delinquency and default rates, and cashflows into and out of the loan loss reserve and revolving fund accounts. Finally, SBA conducts a review of all Microloan Intermediary audited financial statements.

3. Are there any specific industries that pose a risk to the health of the SBA's loan programs? If so, what are they?

SBA RESPONSE:
The Accommodations sector is the largest sector in both the 7(a) and 504 portfolios. In the event of a downturn in the economy, this sector could experience increased stress. Consequently, this is a sector that OCRM monitors closely.

4. What performance trends are you seeing within the 7(a), the 504/CDC, the Microloan, and the Community Advantage programs?

SBA RESPONSE:
7(a):
Since its peak in mid-2017, the Small Business Portfolio Score (SBPS) continues to show a gradual decrease in the credit quality of the 7(a) portfolio. The current average SBPS is 186.3, still in the moderate risk range. This declining SBPS trend is not surprising, as the SBA portfolio is countercyclical to the national economy. When the economy is weak, as during the Great Recession, lenders restrict conventional lending and the SBA portfolio expands with stronger borrowers. When the economy is strong as it is now, lenders expand their conventional credit box, so higher risk loans enter the SBA portfolio.

504:
After peaking in credit quality in early 2017, the average SBPS score has decreased and is currently 193.4.

Community Advantage:
As of FY 2019 Q4, the average SBPS score was 171 and the last 12 month default rate is 6.1%. Both of these metrics have increased in risk since Q4 of FY 2018 when the CA program had an SBPS of 173 and a 12 month default rate of 5.1%.

Microloan:
Due to the recency of OCRM's oversight of Intermediaries in the Microloan program, we are unable to provide current risk metrics.

5. What are the default rates or purchase rates for the 7(a), the 504/CDC, the Microloan, and the Community Advantage programs?

SBA RESPONSE:

7(a):

The early default rate is 1.08%. The 12 month default rate is currently 2.66%.

504:

The early default rate is 0.29%. The 12 month default rate is 0.68%.

Community Advantage:

Community Advantage loans have an early default rate of 2.83% compared to 1.52% for small 7(a) loans (<= $250,000). The last 12 month default rate is 6.13% compared to 3.42% for the small 7(a) loan portfolio.

Microloan:

OCRM is currently initiating oversight of the Microloan program. This performance data was provided by the Office of Financial Assistance, and has not yet been validated by the OCRM team.

The 2019 annual default rate for the Microloan program was 6.49%.

6. It is critically important that the SBA's lending programs work on behalf of America's small businesses and not "padding" a bank's bottom line or investors who take advantage of these programs. Is the Office of Credit Risk Management concerned about investors participating in the 504/CDC Loan Program?

SBA RESPONSE:

Not at this time. OCRM tests for eligibility during its review of CDC loan files. SBA regulations state that passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies under 13 CFR § 120.111) are not eligible. (13 CFR§ 120.110(c))

7. How often are lending partners examined or reviewed within the 7(a), the 504/CDC, the Microloan and the Community Advantage programs?

SBA RESPONSE:

7a Federally Regulated:

Quarterly data analysis/ review is performed on every lender with an active portfolio.

Lenders with SBA Share Dollars greater than $10.0MM are subject to a risk based review approximately every 24 months and OCRM strives to review the majority of Lenders with SBA Share Dollars between $1.0MM and $10.0MM every 36 months. On a case-by-case basis, OCRM may also select Lenders with SBA Share Dollars less than $1.0MM for review.

The previously mentioned reviews are in addition to review activities that are performed prior to any action related to delegated authority (e.g., nomination, renewal, extension, and denial of PLP, SBA Express, Export Express and/or PLP-EWCP).

Community Advantage Lenders:

OCRM reviews internally prepared financials quarterly and CPA-prepared audited reports annually. There are 114 Community Advantage lenders with at least 1 Community Advantage loan outstanding. SBA began conducting targeted loan file reviews of Community Advantage lenders with outstanding loans in FY 2018. We conducted 10 reviews in FY 2018, 10 reviews in FY 2019, and plan to conduct 31 reviews in FY 2020.

SBLCs & NFRLs:

As the primary Federal regulator for SBLCs, SBA conducts on-site safety and soundness examinations of SBLCs no less frequently than every other year. The frequency of Full and Targeted Reviews of NFRLs depends on the lender's size and risk characteristics.

CDCs:

SBA conducts on-site reviews of the largest CDCs (those with $350 million or more in 504 loans outstanding) at least once every three years. Depending on the results of the previous review and risk characteristics of smaller CDCs, SBA normally conducts a SMART review of CDCs with $50 million to $350 million in 504 loans at least once every four years. The smaller CDCs (with less than $50 million in 504 loans outstanding) may receive a review once every five years. In FY 2020, SBA has scheduled reviews of more than 25% of all CDCs.

Microloan Intermediaries:

SBA conducts on-site visits and reviews the audited financial statements of all Microloan Intermediaries on an annual basis. On a quarterly basis, SBA conducts a review of each Intermediary's microloan portfolio status, collateral coverage on the SBA debt balance, microloan delinquency and default rates, and cashflows into and out of the loan loss reserve and revolving fund accounts.

8. Last Congress, the SBA's Office of Inspector General released a report auditing the poultry industry. How did the Office of Credit Risk Management respond to this audit?

SBA RESPONSE:

The Office of Capital Access held two public forums in Gainesville, GA and Little Rock, AR in August of 2018 to better understand the use of SBA guaranteed loans by small farmers in the poultry industry. Following these public meetings, SBA reviewed and revised existing rules on affiliation in general, and included in the Interim Final Rule published 2/10/2020 specific requirements for small businesses that have a significant economic dependence on a larger entity that addresses the issue and recommendations of the OIG in its Evaluation Report on SBA 7(a) Loans Made to Poultry Farmers.

From Rep. Ross Spano (R-FL)

1. As you know, the SBA's Office of Inspector General is wrapping up an audit of the Community Advantage Loan Program. How have Community Advantage loans performed over the last year? Is performance improving year over year?

   SBA RESPONSE:
   Community Advantage loans tend to perform worse than other 7(a) loans of similar size and 7(a) underserved loans of similar size. On average, the performance is declining year-over-year. As of Q4 of FY 2019, the average SBPS was 171 and the 12 month default rate was 6.1% (i.e. higher risk). Both have increased in risk since Q4 of FY 2018 with an average SBPS of 173 and a last 12 month default rate of 5.1%.

2. In the fall of 2018, the SBA released a notice that extended the Community Advantage Pilot Program through September 30, 2022. Beyond extending the program, the SBA also made numerous adjustments to monitor and mitigate risk. Please explain to the Committee the decision behind these changes and what the Office of Credit Risk Management has learned from these changes.

   SBA RESPONSE:
   SBA issued the 2018 notice announcing changes to the Community Advantage Pilot Program with the intent to refine and improve the program experience for participants, improve their ability to deliver capital to underserved markets, and appropriately manage risk to the Agency. Before this notice, SBA had conducted an analysis to compare the performance of Community Advantage (CA) loans to other similar groups of 7(a) loans and to the entire 7(a) portfolio and found that CA loans exhibit more risk. The analysis also found that the CA loan portfolio had a higher early problem loan rate, higher early default rate, and the last 12 month default rate was trending higher than other similar 7(a) loans and the overall 7(a) portfolio. In an effort to mitigate this risk and in order to ensure that SBA's Office of Credit Risk Management was able to properly oversee lenders participating in the CA Pilot Program, SBA placed a moratorium on the acceptance of new Community Advantage Lender Participation Applications and revised other program requirements.

Given the fact that new loans take two to three years to season, it is premature to draw conclusions about how the 2018 changes to the program have affected overall performance of the Pilot Program.

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